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TO RUEHC/SECSTATE WASHDC 4187
RUEATRS/DEPT OF TREASURY WASHDC
INFO RUCPDOG/USDOC WASHDC
RUEHBK/AMEMBASSY BANGKOK 3599
RUEHBJ/AMEMBASSY BEIJING 6388
RUEHUL/AMEMBASSY SEOUL 8483
RUEHGP/AMEMBASSY SINGAPORE 6824
RUEHKO/AMEMBASSY TOKYO 8513
RUEHML/AMEMBASSY MANILA 9958
RUEHJA/AMEMBASSY JAKARTA 4008
RUEHKL/AMEMBASSY KUALA LUMPUR 3689
RUEHHI/AMEMBASSY HANOI 3241
RUEHBY/AMEMBASSY CANBERRA 4460
RUEHWL/AMEMBASSY WELLINGTON 1723
RUEHHK/AMCONSUL HONG KONG 7625
RUEHGH/AMCONSUL SHANGHAI 0836
RUEHGZ/AMCONSUL GUANGZHOU 0014

UNCLAS SECTION 01 OF 02 TAIPEI 000409

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STATE PLEASE PASS USTR
STATE FOR EAP/RSP/TC, EAP/EP
USTR FOR ALTBACH AND STRATFORD
USDOC FOR 3132/USFCS/OIO/EAP/WZARIT
TREASURY FOR OASIA/LMOGHTADER
TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF
GOVERNORS, NEW YORK FRB/MARA BOLIS AND SAN FRANCISCO FRB/TERESA
CURRAN

E.O. 12958: N/A
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SUBJECT: Taiwan Banking Sector Update

REF: (A) TAIPEI 0049, (B) 06 TAIPEI 4175

SUMMARY

1. This report covers the 42 Taiwan banks, 28 credit coops, and 278 Farmers/Fishermen Association (FA) credit departments which constitute Taiwan's banking sector. In 2006, delinquent credit/cash card debt eroded profitability of Taiwan banks which, nevertheless, remained relatively healthy in terms of non-performing loan (NPL) ratio and capital adequacy (CA) ratio. Both credit coops and FA credit departments were more profitable than banks in 2006, however FA credit departments had disturbingly high NPL ratios and low CA ratios. END SUMMARY.

Definition and Market Structure

2. Taiwan banks are licensed to do all kinds of banking services without restrictions on location and customers. Both credit coops and FA credit departments are subject to strict limits on banking services they may provide (only basic services) and on customers served (only local members). The basic banking services include taking deposits, offering loans, and foreign currency exchange.

3. Banks, naturally, are the backbone of Taiwan's banking sector, with 92% of assets and 94% of loans. Credit coops' combined market share is only 2.4% of assets and 2% of loans, while FA credit departments have a combined market share of 5.5% of assets and 3.6% in loans.

Credit/Cash Cards

4. Taiwan permits banks to issue credit/cash cards but does not

allow credit coops and FA credit departments to do so. A sharp increase in delinquent credit/cash card debt in 2005 and 2006 eroded the profitability of Taiwan banks in these two years. Total delinquent credit/cash card debt charged-off shot up from NT\$32 billion (US\$970 million) in 2004 to NT\$71 billion (US\$2.15 billion) in 2005 and NT\$163 billion (US\$4.9 billion) in 2006.

15. Taiwan banks' pre-tax profits, therefore, dropped from NT\$155.4 billion (US\$4.7 billion) in 2004 to NT\$78.6 billion (US\$2.4 billion) in 2005 and NT\$31.9 billion (US\$968 million) in the first 11 months of 2006. Their return-on-asset (ROA) ratio slipped from 0.6% in 2004 to 0.3% in 2005 and 0.12% in November 2006. Their return-on-net worth (ROE) ratio fell from 10.3% in 2004 to 4.8% in 2005 and 1.87% in November 2006.

Low NPL Ratio, High CA Ratio

16. Under Taiwan's first stage of a financial reform program that began in 2002, Taiwan banks wrote off bad debt while maintaining their capital adequacy. Banks' cut their NPLs by nearly 80%, down from NT\$1,676.5 billion (US\$50.8 billion) in early 2002 to NT\$366 billion (US\$11 billion) in December 2006. Correspondingly, Taiwan banks' NPL ratio dropped from nearly 12% to 2.1% while bad debt reserves increased from 14% to a new high of nearly 60% and the average CA ratio remained above 10%. Among the 42 Taiwan banks, 36 reported NPL ratios below the generally acceptable 5% level.

Insolvent Banks

17. Three of the six banks with NPL ratios above 5% were taken over
TAIPEI 00000409 002 OF 002

by the Central Deposit Insurance Corporation (CDIC) in late 2006 (refs A and B). The CDIC will sell the three banks under receivership this year. One of the remaining three banks reported a marginal NPL ratio of 5.4%. Negotiations on the acquisition of the other two banks are currently under way.

Credit Coops in Good Shape

18. The 28 credit coops have reduced their total NPLs by 90% from NT\$50 billion (US\$1.5 billion) in early 2002 to NT\$6.4 billion (US\$194 million) in November 2006. Their average NPL ratio dropped from 16% to 1.8%, bad debt reserves increased to 38% in December 2006, and average capital adequacy ratio in 2005 exceeded 12%. (Note. Taiwan's Central Bank will publish the 2006 figure in June 2007.) Credit coops which had a combined loss of NT\$1.3 billion in 2002 reported a ROA ratio of 0.28% and a ROE ratio of 4.5%. Of the 28 credit coops, 26 reported NPL ratios below 4% in December 2006. The NPL ratios of the remaining two were 4.8% and 4.9%.

Worrisome FA Credit Departments

19. A large number of the 278 FA credit departments have poor credit reputations, and are on the verge of insolvency. Their NPLs declined by 60% from NT\$131.4 billion (US\$4 billion) in early 2002 to NT\$53.8 billion (US\$1.6 billion) in December 2006, and their average NPL ratio also declined from nearly 20% to 8% during the same period. However, over half of them (about 52%) still had NPL ratios above 5%. Among the 278 FA credit departments, 101 reported their NPL ratios exceeding 10%, and 95 of the 101 reported bad debt reserves below 30% of their NPLs.

COMMENT

10. FA credit departments have received less attention since regulatory authority over them was shifted from the Bureau of Monetary Affairs (the predecessor of the Banking Bureau in the Financial Supervisory Commission) to the Bureau of Agricultural Finance in January 2004. Many FA credit departments now risk insolvency due to high NPLs and insufficient bad debt reserves. The

Financial Reconstruction Fund (FRF), equivalent to the RTC in the United States, has NT\$22 billion earmarked for addressing insolvent FA credit departments. However, this amount may not be sufficient to resolve so many problem FA credit departments.

YOUNG